

# The rise and fall of the UK Operating and Financial Review

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# THE RISE AND FALL OF THE UK OPERATING & FINANCIAL REVIEW

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## 1. Introduction

This paper examines the unexpected and controversial withdrawal of a legally required statement of management commentary in the UK, the Operating and Financial Review (OFR). The OFR had been voluntarily disclosed by a majority of UK listed companies since the early 1990s, and from 2002 it was proposed that would become a legal requirement. During 2004, legislation requiring mandatory disclosure of an OFR had been drafted, and a reporting standard prescribing the contents of an OFR had been prepared by the UK accounting standard setter. After years of planning, the legislation was enacted in March 2005. However, in November 2005 during a conference speech to the largest and most influential business lobbying group in the UK, the Government unexpectedly announced the withdrawal of the OFR legislation. The controversial announcement attracted widespread criticism from interested parties and was legally challenged in a judicial review. The Government justified its decision as a deregulatory move but new legal requirements for management commentary by listed companies, announced in November 2006 and implemented by 2007, reinstated many of the elements specified in the withdrawn OFR legislation. This paper analyses the drafting, enactment and repeal of the 2005 legislation within its wider social, political and economic context and draws on Lukes' (2005) conceptualisation of power to consider the circumstances under which policy makers withdrew the OFR in the absence of formal or concerted political lobbying.

The paper aims to contribute to the political economy of accounting regulation by using a rare form of data, private UK Governmental papers, in conjunction with other primary and secondary data sources, to demonstrate the process by which political ideology, enacted through a deregulatory initiative, influenced accounting regulation with unintended consequences. The analysis discusses how officials within the UK financial ministry, the Treasury, headed by a

powerful PM-in-waiting Gordon Brown, sought to identify deregulatory opportunities in order to gain political support. The paper demonstrates how the OFR was identified and constructed as a deregulatory opportunity by Treasury officials, even though accounting regulatory matters remained under the notional responsibility of the trade and industry ministry, the DTI. The Governmental papers reveal how Treasury officials sought to gain support for their policy proposal from the largest business lobby group in the UK, the Confederation of British Industry (CBI), and how the CBI were specifically privileged above other Government ministers in their involvement in the formation and communication of the policy.

However, the deregulatory move to abolish OFR legislation was largely rejected by the community it was intended to serve and subsequent actions by officials in performing a regulatory U-turn six months later suggest that the repeal of the OFR did not deliver the anticipated political gain. The case is used to illustrate the process by which accounting regulation is influenced by political ideology and, in doing so, seeks to further our understanding of management commentary technology in the UK. In contrast to cases where political and ideological influences lead to predictable regulatory outcomes, this paper examines the circumstances under which the power of political influence was largely resisted by those it was intended to benefit, leading to an unpredictable regulatory outcome.

The next section discusses the key theoretical themes used to analyse the political economy surrounding the rise and fall of the OFR before section 3 details the primary and secondary sources used within this investigation. Section 4 details the events surrounding the enactment and repeal of the OFR. The first part of the analysis in section 5 considers how the newly enacted statutory OFR came to be constructed as a deregulatory solution in relation to the political strategy of the UK Labour party, and how the CBI was enrolled in enacting its repeal. The second part of the analysis focuses on why Treasury officials selected the OFR for deregulation, and how the repeal did not deliver the anticipated political support. Section 6 presents the discussion before concluding observations are made in Section 7.

## **2. Theoretical Background**

Within the political economy of accounting regulation, accounting legislation, standards and practices provide visibility on particular features of an organisation, and, in doing so, reflect and constitute social and economic relations (Young, 1994; Perry & Nolke, 2006; Chapman et al., 2009; Robson & Young, 2009). As the impact of accounting information is not neutral across

different social groups the formation of accounting regulations has long been recognised as a political process in which accounting language and practice will embody the power relations prevailing in society (Cooper & Sherer, 1984; Robson, 1993; Chapman et al., 2009).

A large body of research has investigated the formation of accounting regulations through the examination of public responses to consultation and the historical development of exposure drafts, discussion papers and accounting standards (see for example, Francis, 1987; Hochberg et al., 2009). Rational choice and exchange theories of regulation propose that lobbyists rationally choose their positions based on the perceived economic consequences of regulation and the probability of influencing the regulatory decision (for example, see Watts & Zimmerman, 1978; Sutton, 1984). However, research has also argued that the deliberations of human actors and their constituent groupings are based on more complex internal and discursive processes that may not be economically rational nor freely chosen and are neither transparent nor easily observable from standard setting procedures (for example, see Hope & Gray, 1982; Fogarty, 1992; Robson, 1993; Walker & Robinson, 1993; Young, 1994; Susela, 1999; Cooper & Robson, 2006; Hodges & Mellett, 2012). As Robson & Young (2009: 351) note, “multiple actors, often with conflicting purposes, may advocate similar accounting practices but whether these practices will serve an intended purpose cannot be assumed”.

Within the political economy of advanced capitalism, the dynamic relationship between the market, the State and society will provide distinct and differential sources of influence (Puxty et al., 1987). In accounting regulation, private standard setters can be seen to occupy an uneasy position in regulatory space at the nexus among the accounting profession, big business and the State (Young, 1994). Since the 1970s the State is argued to have taken an increasing interest in accounting standards seeing them as an important element of industrial and financial policy (Cooper & Robson, 2006) and prior studies have explored episodes of State intervention into accounting regulation in different empirical settings (for example, in the cases of accounting for business combinations (Ramanna, 2008; Zeff, 2005a), current cost accounting (Robson, 1994), accounting for oil and gas exploration (Cortese, 2011; Cortese et al., 2010; Gorton, 1991; Zeff, 2005b), value added statements (Burchell et al. 1985) and accounting for Private Finance Initiative (PFI) activity (Broadbent & Laughlin, 2005; 2002).

Compared with the regulation of accounting standards governing financial statements and notes, narrative reporting regulation is arguably less stable and formalised. Narrative reports concerning management commentary, ‘sustainability’, director remuneration and corporate

governance are generally subject to more heterogeneous regulatory arrangements across nations involving, for example, differential sources of influence from national company law, State regulators, capital market regulators and national and supranational accounting standard setters. The focus of this study, management commentary, has historically been regulated by national jurisdictions and has not, until recently, been subject to international regulation. A ‘best practice’ statement on management commentary was released by the International Accounting Standards Board (IASB) in 2010 but unlike standards governing financial statements and notes, the guidelines are non-binding due to the multitude of different legal requirements and practices in operation across major developed economies (see IFRS, 2010). As a result, management commentary requirements and reporting content retain national characteristics due to differences in, for example, required levels of assurance and director liability. In many jurisdictions, management commentary is subject to regulatory procedures distinct from those governing accounting standards due to its location outside the financial statements and notes. For example, in the US, the regulation and content of management commentary is retained by the Securities and Exchange Commission (SEC) rather than being delegated to Financial Accounting Standards Board (for example, see Hooks & Moon, 1993). This study is set, therefore, in the regulatory space occupying the margins of formalised and stable accounting standard setting where domestic institutional arrangements act as the focal point for global corporate narrative reporting practices.

A key theoretical construct in the political economy of accounting regulation is recognised as power (Cooper & Robson, 2006; Bengtsson, 2011; Malsch & Gendron, 2011). As Hope & Gray (1982: 531) note, “an understanding of how, when and by whom power is exercised is widely recognised as a necessary pre-requisite of any rigorous analysis of the political process”. Power relations influence what is and what is not on the regulatory agenda, the nature of the choices available and who participates in a particular regulatory space (Hancher & Moran, 1989).

Power is conceptualised both in terms of domination or ‘power over’, and in terms of ‘power to’: a capacity that can be simultaneously positive (providing autonomy) and negative (restricting the autonomy of others) (see Morriss, 2002; Clegg et al., 2006; Gohler, 2009; Clegg & Haugaard, 2009). The analysis of the OFR repeal draws on Lukes’ (2005) three dimensional (3-D) notion of ‘power-over’ to consider the process by which ideology can influence the

dispositions of regulatory agents and their consequent preferences for accounting regulation (see Arnold, 2009b; Zhang et al., 2012).

Lukes (2005) explicitly sought to differentiate the normative assumptions upon which existing accounts of ‘power over’ were based and, in doing so, classified power into three dimensions. He identified a 1-D view, exemplified by Dahl (1984), as overt demonstrations of power where conflict is revealed by participation in the decision making process. A 2-D view recognised how agenda building and the mobilisation of covert bias could facilitate some decisions and exclude others from analysis (see Bachrach & Baratz 1970; Haugaard, 2009). Lukes’ (2005) 3-D view extends the scope of power to consider how power relations, expressed as a capacity to act rather than the exercise of that capacity, can coercively constrain regulatory thinking. In doing so, it considers how collective forces and social arrangements may limit choices and affect the dispositions of decision makers. Lukes drew on the work of Gramsci in considering how the effect of ideological or hegemonic power could frame political and regulatory preferences (see Clegg et al., 2006; Merino et al., 2010) and sought to capture how ‘soft’ power relations could operate through the ‘management of meaning’ (Gordon, 2009) and self-censorship to preclude alternatives to the status quo (Malsch & Gendron, 2011). Politicians, for example, may perceive that it is ‘natural’ to favour particular interest groups in setting corporate regulation, in the absence of formal lobbying, due to their need for political support. Lukes’ exposition of how socially structured and culturally patterned behaviour can lead to self censorship (‘macro’ ‘power over’), is linked to notions of ‘micro’ ‘power to’ that emphasise how individuals objectify themselves as seen by others and whose choices (‘dispositions’ or ‘truths’) may be constituted by structures of legitimizing discourse and pervasive social practices and habits (see Clegg & Haugaard, 2009; Dean, 2009; Gohler, 2009; Vogler, 1998; Malsch & Gendron, 2011). Perceptions of power relations can then become reified over time through their normality (Gordon, 2009) and regulatory bodies may be regarded as being political in normalising particular views of social or economic relations (Sikka, 2002).

Prior research into corporate and accounting regulation has examined how political and ideological power has influenced regulatory dispositions and choices in different empirical settings. For example, Merino et al. (2010) explore the role of neo-liberal ideology in the preservation of shareholder primacy in the development of the US ‘Sarbanes-Oxley’ Act. Malsch & Gendron (2011) examine the role of 3-D power in the development of Canadian auditing (self) regulation (see also Broadbent & Laughlin, 2005; 2002; Burchell et al. 1985; Carter et al., 2011;

Hope & Gray, 1982; Zhang et al., 2012). Regulatory outcomes are characterised as enabling accounting practices generally consistent with the prevailing ideology. However, the statutory OFR provides a case in which the influence of a political ideology led to an unexpected regulatory outcome consistent with Lukes' (2005) observation that power may have unpredictable effects where actors misinterpret the sources of power. This case provides an opportunity to analyse the circumstances under which this happened and seeks to examine the conceptualisation of hegemonic ideological power by demonstrating that unpredictable and unintended actions may result from how actors perceive and act on their understandings of power relations.

The remainder of the paper explores the influence of a neo-liberal deregulatory ideology, prevalent in the pre-financial crisis environment in the UK, on the development of management commentary regulation. The analysis draws on Lukes' 3-D conceptualisation to depict how neo-liberal ideological power was transmitted through a government initiative of corporate deregulation that led to the controversial decision to repeal the OFR at the annual conference of the largest business lobbying group in the UK. The empirical materials demonstrate how the Government's deregulatory initiatives, embedded with a neo-liberal ideology, acted as a rationale to justify the selection of the OFR for repeal. The analysis considers the influential discourses such as 'gold-plating' that were commonly used to linguistically frame and convey the deregulatory ideology during this time. The Government papers are used to explore why officials perceived that the repeal of the OFR would generate political support, and why their perceptions proved to be misplaced given that the deregulatory move was largely rejected by its perceived beneficiaries. In identifying why the Government was forced into a subsequent regulatory U-turn, the paper illustrates how, given the interpretations of regulatory actors, hegemonic power can lead to unpredictable outcomes.

### **3. Research Method**

The interpretive approach of this paper draws on qualitative primary and secondary data sources detailing the development and repeal of the OFR. Within this dataset, the analysis draws centrally on private ministerial papers prepared for the UK Chancellor (later Prime Minister) Gordon Brown by Treasury officials. Although studies of accounting regulation are often focused on the analysis of publicly available written submissions and arguably only examine the overt exercise of power due to the limited availability of empirical materials (Walker &

Robinson, 1993) researchers also recognise that many issues affecting the determination of accounting standards are resolved in informal, private settings (Georgiou, 2004) away from public scrutiny (Kwok & Sharp, 2005) and involve few people (Cooper & Robson, 2006). As MacDonald & Richardson (2004) observe, where regulatory practices are conducted *in camera*, publicised outcomes are unlikely to reveal much about the process or influence exercised. It is usually difficult to observe whether and how regulators have been swayed by key interest groups: hence many studies are constrained to focus on the outcome of the regulatory process rather than the ‘black box’ of internal decision making. Therefore, this study draws on internal UK Government briefing documents made publicly available by an environmental pressure group, Friends of the Earth, which had launched a judicial review against the decision to repeal the OFR legislation. Notes from four internal meetings and four internal private papers, written for the UK Chancellor, were only released as part of the pre-action protocol prior to the judicial review and in response to requests made under the UK Freedom of Information Act. These papers, along with correspondence between the Treasury solicitors and Friends of the Earth offer a rare opportunity to analyse the political economy of accounting by considering the process by which regulators formed their policy preferences and how they perceived private meetings with different interest groups. The briefing papers were examined to identify and code common themes, rhetoric and chronology for analysis. The papers, detailed in Table 1, cover a 6 month period preceding the public announcement of the Government’s unexpected decision to repeal the OFR legislation on 28 November 2005.

Table 1: Government OFR Briefing Papers

Meeting notes released to Friends of the Earth as part of pre-action response
- Hermes (8 June 2005)
- Association of British Insurers (12 August 2005)
- London Stock Exchange (19 August 2005)
- ‘Informal Advisory Group’ (8 November 2005)
OFR Internal discussion note (29 September 2005)
OFR Deregulatory opportunity - note to chancellor (11 October 2005)
OFR Regulations: Proposal to fall back to EU minima – note to chancellor (11 November 2005)
Directors' reporting - removing the statutory requirement to produce an operating and financial review - note to chancellor (23 November 2005)
Letter from Treasury Solicitors to Phil Michaels, Friends of the Earth (22 December 2005)

These primary data sources are supported by public documentation including consultation papers, comment letters, press releases and other public commentary made by



interest groups. The paper continues by describing how the OFR was developed and details the process by which it was repealed.

#### **4. The Development of the Statutory OFR**

From the late 1960s, the US SEC concluded that due to the increasingly complex nature of corporate entities and the unpredictability of the economic environment, investors needed a narrative disclosure of the risks and uncertainties that could not be conveyed by financial statements and footnotes alone (Zeff, 2005). By 1968, the SEC required that registrants disclose Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) (Schroeder & Gibson, 1990; Collins et al., 1993). Detailed narrative reports (described by the IASB (2005) as 'management commentary') developed over time as an outlet for management to disclose 'non-financial', present or future-orientated information. The extant system of corporate reporting, developed for businesses within a traditional manufacturing environment, was considered to be struggling to identify the risks, opportunities, intangibles and interdependent organisational relationships of businesses operating in an increasingly knowledge-based, post-industrial society. Within the decision usefulness paradigm, many commentators (for example, AICPA, 1994; DiPiazza et. al, 2006) called for a broadening of the corporate reporting model to provide a wider array of financial and non-financial information to aid decision making.

In the UK, less detailed narrative disclosures had long been reported (for example, within a Chairman's Statement or the Directors' Report – see Edwards, 1989) whilst provision of specific narratives commenting on objectives, strategy and future prospects had been recommended in the Corporate Report in 1975 (ASSC, 1975). By 1993, the UK Accounting Standards Board (ASB) had published voluntary guidance on the disclosure of a MD&A style narrative to be known as the OFR. It was defined as, "a framework for the directors to discuss and analyse the business' performance and the factors underlying its results and financial position, in order to assist users to assess for themselves the future potential of the business" (ASB, 1993 para. 1). The 1993 OFR guidance focused on the content of disclosures rather than their location within a single narrative statement and, as a result, disclosures tended to be distributed across several narrative statements with significant repetition (Rutherford, 2003). However, in contrast to the US MD&A which focused on financial matters and explaining changes in the financial statements (AICPA, 1994), the ASB also recommended commentary on

operational issues (Beattie & McInnes, 2006). By 1998, the International Organization of Securities Commissions (IOSCO) had also recommended the provision of management commentary in an ‘Operating and Financial Review and Prospects’ in its International Disclosure Standards for listed companies (ASB, 2007). Therefore, during the 1990s, the OFR became an accepted part of UK corporate reporting technology and, indicative of ‘best’ practice, was disclosed by the majority of large UK-listed companies. For example, by 2000 Deloitte (2005; 2006) reported that 68% of FTSE 350 companies either produced an OFR or clearly adopted the OFR guidance provided by the ASB.

As part of proposals to reform company law initiated by the UK Labour Government, a statutory OFR for listed companies was recommended in 2000 (Company Law Review Steering Group, 2000). Motivated by the increasingly complex nature of financial statements (HM Treasury Solicitors, 2006), the rationale for a statutory OFR was arguably strengthened by the focus on corporate reporting prompted by the 2001-02 global accounting scandals and the perceived need for a political response (Ball, 2009; HM Treasury, 2005c: 3). The statutory OFR was formally recommended by the UK Government in a July 2002 ‘White Paper’ (DTI, 2002) and an OFR Working Group was set up in December 2002 to guide directors in preparing an OFR (DTI, 2004). A timeline highlighting its development is shown in Table 2.

Table 2: Statutory OFR Timeline

Mar 2000	The Company Law Review proposes a statutory OFR.
July 2002	A Statutory OFR is formally proposed in a Government White Paper.
Dec 2002	An OFR Working Group considers OFR guidance/legislation.
June 2003	The EU Accounts Modernisation Directive lays down minimum management commentary requirements for all EU states.
May 2004	Draft OFR Regulations are released by the DTI
Nov 2004	OFR Regulations (SI 2005/1011) are passed & Reporting Exposure Draft 1 is released by the UK ASB for comment
Mar 2005	OFR Regulations (SI 2005/1011) become active on 22 March.
May 2005	Reporting Standard 1 is released by the UK ASB
Nov 2005	The Government announces it will repeal the statutory OFR.
Jan 2006	Repeal legislation (SI 2005/3442) is passed but is subject to a legal challenge led by Friends of the Earth.
Feb 2006	A new government management commentary consultation commences in response to the legal challenge
May 2006	New (Enhanced) Business Review requirements are proposed for inclusion in the forthcoming Companies Act 2006.
Nov 2006	The Business Review legislation is passed within the Companies Act 2006

In June 2003, the EU Accounts Modernisation Directive (hereafter, AMD) 2003/51/EC required member states to introduce legislation to ensure that all large and medium sized companies disclose management commentary within their annual reports in a revised Business Review in the Directors' Report (effective by January 2005) (EU, 2003).<sup>1</sup> Listed companies were expected to make additional non-financial disclosures, to the extent necessary for an understanding of the business, relating to employee and environmental matters in an 'enhanced' Business Review (Williams & Conley, 2007).<sup>2</sup>

In May 2004, the UK Government's Department of Trade & Industry (DTI) published draft regulations on the OFR and Directors' Report (DTI, 2004) whilst simultaneously publishing the implementation guidance for directors produced by the OFR Working Group. The AMD applied to all medium and large companies but the statutory OFR only applied to listed companies. Therefore the draft OFR regulations revised the Directors' Report requirements in company law for non-listed companies so that they were consistent with the AMD but gave specific additional detail about how listed companies should provide an OFR. Although the aim of both the Business Review and the OFR was to provide a 'balanced and comprehensive analysis of the development and performance' of the business, the regulations differed from the AMD requirements for listed companies by expanding on the contents of the statutory OFR. For example, in common with the existing non-mandatory OFR guidance provided by the ASB, statutory OFR disclosures were expected to analyse the main trends and factors underlying the development, performance and position of the company as well as those likely to affect it in the future. Furthermore, unlike the AMD, the OFR legislative proposals referred to specific disclosures such as objectives, strategies, resources, capital structure, treasury policy, liquidity, dividends, share issues and essential corporate relations (DTI, 2004).

From its inception, the reform of company law initiated by the Labour Government sought to increase corporate accountability beyond the providers of financial capital (see Company Law Review Steering Group, 1999; 2000). The OFR was designed to complement a broader 'enlightened shareholder value' approach to director duties and act as a reporting mechanism to monitor directors in the context of a non-enforceable pluralist approach (Collinson et al., 2011). Much of the formal lobbying surrounding the formation of a statutory OFR, therefore, concerned its impact on corporate accountability and audit liability arising from both

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<sup>1</sup> Previously, the Companies Act 1985 had required a 'fair review' of the business in the Directors' Report.

<sup>2</sup> The EU Transparency Directive 2004/109/EC, adopted in December 2004, also required listed companies to produce a 'management report' in their interim and annual reports (see IASB, 2006; ASB, 2007).

disclosures on the wider economic, social and environmental impacts of business activity and the provision of forward looking statements. Attempts to increase accountability through the provision of information within an audited report not only exposed corporations to scrutiny, but also heightened the auditors' liability to those who relied on audited information (see Mitchell & Sikka, 1993). After "intense lobbying by business leaders" (Macalister, 2004: 21), key tenets of the 2004 OFR proposals had been changed to limit extensions of accountability or liability.

The 2004 draft OFR regulations had been criticised by the accounting profession and other industry bodies in relation to their auditing requirements (for example, see Reynolds, 2006). Specifically, the regulations proposed that auditors confirm that directors had made their OFR comments with 'due and careful enquiry'. As the wider company law reforms proposed jailing auditors if they 'knowingly and recklessly' gave false audit opinions, it was thought that auditors would restrict disclosures for fear of incurring criminal liability.<sup>3</sup> Similarly, it was considered that the lack of any 'safe harbour' protection for directors' liability would inhibit them when making forward looking statements (CIMA, 2005a). Consequently, the DTI 2004 draft OFR regulations were criticised for potentially generating 'boilerplate' representations written by lawyers, rather than by management, due to the fear of litigation. Therefore, this requirement was downgraded in the final OFR regulations: auditors were required to confirm that the OFR was merely 'consistent' with the financial statements and any other matters which had come to their attention during the audit (Secretary of State, 2005a).

The EU AMD requirements were enacted in the UK by Statutory Instrument 2005 no.1011, Companies Act 1985 (Operating & Financial Review and Directors Report etc.) Regulations 2005 (announced on 25 November 2004). This required all listed companies to provide an OFR from financial years starting 1 April 2005 (delayed from 1 January 2005) whilst non-listed medium and large companies would be required to produce a revised Business Review as part of their Directors' Report. The government ministry responsible for corporate reporting, the DTI (2005: 10), noted positively that,

"the requirement to produce an OFR represents a further major step forward in improving company reporting and transparency and in promoting effective dialogue on the key drivers of long-term company performance".

The legal authority to create an OFR reporting standard (prescribing its content) was conferred on the non-governmental standard setting body, the ASB, under section 13 of the Companies (Audit, Investigations and Community Enterprises) Act 2004. Drawing on responses

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<sup>3</sup> Later drafts sanction fines rather than jail sentences against auditors (Bolton, 2005).

to the draft regulations and the implementation guidance for directors, an Exposure Draft of a Reporting Standard on the OFR (RED 1) was issued by the ASB on 29 November 2004 in accordance with its usual consultation procedures. After receiving responses to the Exposure Draft, the full OFR standard, RS 1, was published in May 2005.

In common with the draft OFR regulations, the lobbying positions taken on RED 1 focused upon the impact that the statutory OFR might have on corporate accountability and liability. The 2002 Government White Paper and draft 2004 OFR regulations specified the target audience of the statutory OFR as ‘members’ (DTI, 2002:38; 2004). However, RED 1 widened the audience to ‘investors’ to the consternation of the CBI who were concerned that this would include unspecified potential as well as present investors (CBI, 2005). They suggested that, unless the specified target audience was narrowed, directors would respond by including disclaimers of liability to users other than shareholders and adopt a legalistic approach to preparing the OFR, thereby stifling innovative reporting and (again) producing ‘boilerplate’ disclosures (CBI, 2005). Therefore, under RS1 the audience was re-specified as ‘members’, thereby reducing the scope of third party liability for directors.

As businesses began to respond to stakeholder demands by appending reports with ‘corporate social responsibility’ style information, narrative reports such as the statutory OFR came to be seen as a potential vehicle for pluralist stakeholder reporting (Owen et al., 2005; Cooper & Owen, 2007; Solomon & Edgley, 2008; Collinson et al., 2011). The Labour party also commissioned a report, *Accounting for People*, which recommended that information on human capital management should be included in any expanded OFR (Task Force on Human Capital Management, 2003; Roslender & Stevenson, 2009). The draft 2004 OFR regulations had suggested that,

“the OFR will be of interest to other stakeholders, such as employees, suppliers and customers of the company, and other users of reports and accounts such as those with an interest in the environment” (DTI, 2004:18).

However, although this clause was repeated in RS 1, the ASB attempted to emphasise further the primacy of the shareholder/member audience by stating that,

“the OFR should not, however, be seen as a replacement for other forms of reporting to a wider stakeholder group.” (ASB, 2005, para8).<sup>4</sup>

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<sup>4</sup> This issue appeared to parallel discussions within the IASB over the intended audience of the financial reports specified in the (proposed) IASB conceptual framework. RS 1 was consistent with the IASB notion that

Overall, reaction to the changes made during the formation of the statutory OFR (as published in Statutory Instrument 2005/1011 and RS 1) polarised opinion on predictable grounds. Friends of the Earth described them as “all but meaningless” and that, “the Government is clearly willing to ignore public concerns and be led by the nose by the business lobby” (Friends of the Earth, 2004: 1). Contrastingly, the CBI described them as “excellent” because “the original proposals contained serious flaws that frankly would have killed the OFR” (Macalister, 2004: 21).

On 28 November 2005 in a speech at the annual conference of the CBI, the Chancellor of the Exchequer unexpectedly announced that the requirements for a mandatory OFR would be scrapped. The release of press comment immediately prior to the CBI conference described the repeal as a ‘cut in red tape’ (see for example, Duncan & Rozenberg, 2005; The Sun, 2005). The Treasury, the financial ministry under the Chancellor’s control, explained that the Government did not want to impose regulations over and above those required by the EU AMD (HM Treasury, 2005e). Subsequently, the OFR legislation was repealed by the Companies Act 1985 (OFR)(Repeal) Regulations 2005 SI 2005/3442 which came into force on 12 January 2006 (Secretary of State, 2005b) and the ASB’s RS1 was downgraded to a voluntary reporting statement of best practice.

The repeal decision was controversial, prompting widespread criticism from many interest groups as well as legal action against the Government. On 11 January 2006, Friends of the Earth launched legal proceedings seeking a judicial review of the repeal decision on the basis of insufficient public consultation. On 2 February 2006, the Government settled out of court with Friends of the Earth and agreed both to pay their costs and begin a further consultation (Friends of the Earth, 2006). Therefore, on 1 February 2006, the DTI announced it would widen an ongoing consultation on the future of management commentary until 24 March to consider whether any statutory requirements should be placed within Chapter 6, Part 15 of the proposed but not yet enacted Companies Act 2006 (then at the committee stage in the UK Parliament)<sup>5</sup> (DTI, 2006a).

By 3 May 2006, after receiving 109 submissions, the Government recommended new clauses for inclusion in the Companies Act 2006 (DTI, 2006b). As a result, non-listed companies were to provide a Business Review in accordance with the AMD and listed companies were to

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management commentary (and therefore its intended audience of members/investors) was within the scope of the conceptual framework (IASB, 2005, 2009).

<sup>5</sup> Alternatively, the DTI considered introducing new secondary legislation, if legal requirements were required before the Companies Act 2006 was passed (DTI, 2006a)

provide an ‘enhanced Business Review’ which mandated additional disclosures to those required by the AMD due to extensions in directors’ duties. Specifically, the duties considered by directors in fulfilling their primary responsibility to act in a manner “most likely to promote the success of the company for the benefit of its members” were extended to consider fostering “relationships with customers, suppliers and others” after considerable parliamentary debate (Companies Act 2006; Williams & Conley, 2007; Collinson et al., 2011). As the Business Review was required to help members assess how directors performed their duties, the scope of the enhanced Business Review of listed companies also widened, explicitly requiring information “to the extent necessary” on essential contractual relationships with suppliers, customers and others in addition to information on the environment, employees and social and community issues “in a manner consistent with the size and complexity of the business” (Companies Act 2006).<sup>6</sup> Therefore, the final version of the enhanced Business Review for listed companies reinstated requirements from the repealed OFR regulations which were not in the AMD, thereby appearing to contradict the Government’s stated rationale for abolishing a statutory OFR. The Business Review requirements were finally published in the Companies Act 2006, which was granted Royal Assent on 9 November 2006.

In 1998, the Labour Government had begun a reform of company law and a statutory OFR was on the reform agenda from its early phases (see Company Law Review Steering Group, 2000). Only in 2005 did the Labour Government’s Treasury ministry wield its considerable influence by seeking to repeal the statutory OFR as an example of corporate deregulation. The repeal was announced long after costly efforts to formulate statutory OFR regulations and guidance, involving extensive government, civil service and private sector involvement, had been concluded. Why did the Treasury intervene only after both the legislation and a reporting standard had been drafted, passed and agreed? The next section draws on the private ministerial briefing papers and other case evidence to analyse this unexpected and controversial regulatory decision planned behind closed doors.

## **5. Understanding the Repeal Decision**

The first part of section 5 sets out the wider social and political context in which the repeal policy was formulated and highlights the role of deregulatory initiatives such as the Better Regulation Task Force in early 2005. It examines how the Treasury responded in developing

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<sup>6</sup> If a Business Review omitted these issues, listed companies would have to disclose which issues had been omitted.

their policy to repeal the OFR over the summer of 2005 to generate political support in the absence of concerted lobbying and against the wishes of other Government officials. The second part details the reaction to the repeal announcement and considers why the Treasury were unsuccessful in gaining the anticipated political support.

### *5.1 The construction of the statutory OFR as a deregulatory opportunity*

The Labour administration had been elected in 1997 after 18 years of Conservative Party rule, aided by the adoption of a ‘third way’ or centrism model which balanced neo-liberal ‘free market’ solutions with democratic socialism, particularly in funding and managing public-sector institutions (see Broadbent & Laughlin, 2003). Unlike prior Labour administrations in opposition, the party was perceived to have gained the support of the business sector through its promise to adopt fiscal and budgetary prudence, by continuing to embrace a ‘third way’ philosophy and its proactive approach to public relations (see Moran, 2001). Upon entering office, the Labour administration, and particularly Chancellor Gordon Brown, apparently continued to receive the support of business for providing independence to the Bank of England in setting interest rates, supporting a ‘light touch’ approach to financial regulation and presiding over a period of economic prosperity as the UK continued to enjoy an upturn in its economic cycle. The Government also pledged to improve regulation and an independent advisory group, the Better Regulation Task Force, was set up in 1997.

By 2005, this political support had waned particularly due to the unpopularity of UK foreign policy and criticism of the ‘third way’ approach. The Labour Party had won a further term in the UK election on 6 May 2005 but with a vastly reduced parliamentary majority and it was publicly expected that Chancellor Gordon Brown would take over from Tony Blair as Prime Minister in the near future and attempt to revive political support.<sup>7</sup> As Prime Minister-in-waiting, the Chancellor and his ministry, the Treasury, were perceived to wield a great deal of power within the Government (for example, see Broadbent & Laughlin, 2002; Thain, 2004).

Political rivals, led by the Conservative main opposition party, criticised the Labour administration for increasing the level of bureaucracy or ‘red tape’ to which businesses were subject– a common tactic of right wing political parties influenced by economic neo-liberal ideology to prioritise tax cuts and public spending restraint (‘small government’) as opposed to higher public spending and taxes which they attributed to ‘left wing’ politics (Robson, 1993;

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<sup>7</sup> For example, see Assinder (2005)



Young, 1995). Particular criticism was levelled at regulations originating in the EU, which were often characterised as irrelevant and unpopular by the politically influential UK tabloid media<sup>8</sup> and the vocabulary, ‘gold-plating’, became a common term to describe excessive statutory regulation beyond that required by EU regulations (for example, see EC, 2005; HM Treasury solicitor, 2005). Although the UK had been praised for its regulatory policy by both the OECD and the European Commission during the period in which the statutory OFR was developed (Davis & Ward, 2008), the subject of improving regulation had become a key political theme for the Government. In October 2004, the Prime Minister asked the Better Regulation Task Force to investigate ways in which regulatory costs faced by business could be reduced and the Treasury head, Chancellor Gordon Brown, asked a prominent businessman, Philip Hampton<sup>9</sup>, to undertake an associated review of administrative burdens (BRTF, 2005; Hampton, 2005). In its ‘report to the Prime Minister’, released in March 2005 (the same month in which the OFR legislation became active), the Better Regulation Task Force recommended that all Government departments develop a programme of identifying regulations that could be simplified, repealed, reformed or consolidated (BRTF, 2005). Influenced by the Dutch system which found that the ‘top 10’ burdensome regulations related to tax and accounting, the report recommended both revisiting the implementation of EU directives and enlisting business and stakeholders to identify burdensome regulations (BRTF, 2005). The Better Regulation Task Force report appeared to be influential in Government thinking: in detailing the basis for the OFR repeal, the Treasury solicitor (2005:4) explained that,

Following recent initiatives to embed a more effective regulatory approach, government departments were asked to identify opportunities for deregulation. These recent initiatives include the Report of the Better Regulation Task Force (of March 2005), the Hampton Report of March 2005.

With its focus on deregulation the Better Regulation Task Force can be viewed as a mechanism for conveying a politically neo-liberal ideology. Government officials were prompted to proactively seek deregulatory opportunities in private meetings with interest groups. For example, “representatives of companies give especially valuable insights into the impact of regulation on the ground” (BRTF, 2005:30).

An internal Treasury briefing document reveals that a meeting with the pension fund Hermes on 8 June 2005 appears influential in identifying the OFR as a deregulatory opportunity.

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<sup>8</sup> For example, see The Daily Mail (1999).

<sup>9</sup> Currently chairman of Royal Bank of Scotland (RBS).

If we wanted [a] deregulatory win with appeal for big business, a radical symbolic stripping-down of the OFR would go down incredibly well. I see his point. Is it feasible? (HM Treasury, 2005a:1).

In its recognition of ‘symbolic’, rather than substantive deregulation, the briefing note is consistent with the letter of the Better Regulation Task Force recommendations rather than their spirit. The note highlights the politically opportunistic nature of an OFR repeal and its targeted beneficiaries (‘big business’). The assumption that corporate deregulation (the ‘stripping-down’ of the OFR), consistent with a neo-liberal ideology, would ‘appeal to big business’ represents the 3-D power relation – regulatory dispositions in the Treasury were influenced by a political commitment to the economic neo-liberalism prevalent in the pre-financial crisis environment. The briefing note hints at an alternative explanation for withdrawing the statutory OFR to that given by the Treasury solicitor in response to Friends of the Earth:

The Government’s decision to make this adjustment was based primarily on a reassessment of the existing evidence base (HM Treasury solicitor, 2005).

Although Treasury officials were asked to identify “deregulatory opportunities” during July 2005 (HM Treasury solicitor, 2005), it was the DTI that had responsibility for dealing with accounting and auditing matters (see Sikka, 2001), rather than Gordon Brown’s Treasury, and had led the way in developing the statutory OFR. Despite extra costs identified in a regulatory impact assessment, the DTI consistently maintained support for the statutory OFR from the early stages of company law reform, presumably assuming that it generated net benefits. An internal Treasury briefing document dated 29 September 2005 conceded that,

the new reporting requirements are intended to increase transparency in reporting and have been welcomed, or at least accepted, by most stakeholders, including directly affected businesses (HM Treasury, 2005b: 1).

However, Treasury officials were undeterred from recognising the OFR as a deregulatory opportunity and opined that, “while DTI substantively addressed the main concerns of consultees at the time, the OFR still seems expensive” but conceded that, “companies have already begun preparation for the OFR and would see this is a rather belated u-turn” (HM Treasury, 2005b: 1). Within the conclusion to the Treasury document, the ideological power of neo-liberalism is evident in the pressure placed on the DTI to meet its deregulatory targets,

we think it would be useful to work with DTI to see whether options for scaling back current reporting requirements for quoted companies might be explored further, especially in light of the significant cost savings this represents and the pressure on DTI to meet its deregulatory targets (HM Treasury, 2005b: 1).

On 11 October 2005, the deregulatory opportunity identified by Treasury officials was presented to the Chancellor, Gordon Brown. An internal ‘note to Chancellor’ recommends that, rolling back to minimum directive requirements is in line with the Government’s policy on no gold-plating and has presentational attractions (HM Treasury, 2005c: 1).

The note, again, suggests that repeal of the statutory OFR, through its ‘presentational attractiveness’, could generate political support. The term ‘gold-plating’ is also introduced and became a key part of the discourse used to convey the deregulatory ideology rationalising the repeal decision. As a metaphorical expression, it was politically influential and persuasive, particularly to those lacking detailed information about the purpose of the associated regulation (see Amernic & Craig, 2000; Lakoff, 1992). The metaphor implied that domestic regulations beyond those required by the EU were unnecessary but costly adornments without potential benefit: legal jewellery to titillate rather than serve a useful purpose. The term ‘gold-plating’ was often reused by other interest groups such as the British Bankers’ Association (Knight, 2004) and the CBI (2006) and became central in signifying a politically motivated decision as a rational consequence of ‘better’ accounting regulation. Such discourse, often conflating the costs of regulation with its consequences, had been used before in debating corporate reporting change. For example, the “Burdens on Business” (Robson, 1993) cost-benefit analysis criteria on new legislation instigated by the previous UK Conservative administration in the 1980s placed more emphasis, as the term implies, on the cost of regulation for businesses rather than its benefits for society, and ideologically positioned deregulation as the only alternative to competitive decline (Rhodes, 1989; Merino et al., 2010). It is also significant that in the same speech in which the repeal of the statutory OFR was revealed, the Chancellor also announced an investigation by Lord Davidson, former solicitor-general for Scotland, into the ‘gold plating’ of EU directives (HM Treasury solicitor, 2005).<sup>10</sup>

The DTI had apparently addressed the ‘gold-plating’ argument in 2004 upon releasing the draft OFR regulations. For example,

The Government believes that additional burdens over and above those strictly required by EU company law should not be imposed on SME’s unless a clear case has been made of the benefits that will result. The benefits of reporting by large companies on non-financial matters are clear (DTI, 2004: 34)

They believed extra disclosures by large companies, beyond those required by the AMD, would be beneficial because they had a wider shareholder base, they would encourage

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<sup>10</sup> In his final report, Lord Davidson concluded that many allegations of gold-plating were misplaced and the over-implementation of EU directives was not as widespread as was claimed (see Willman, 2006)

shareholder engagement and would be of interest to users as part of the broader approach to corporate accountability. However, it is argued that the ‘rationalising logic’ (Arnold, 2009a) of corporate deregulation in the pre-financial crisis environment, given momentum by the Better Regulation Task Force, and combined with the power of Gordon Brown’s Treasury and its need for political support, prompted a reappraisal of the OFR. The Better Regulation Task Force had specifically recommended removing domestic additions to the application of EU directives but had recognised how deregulatory target setting could influence political behaviour.

There is an obvious danger that setting too high a target could encourage game playing and be an incentive to focus on headline announcements and innovative ways of measuring rather than delivering real reductions (BRTF, 2005:24)

The Better Regulation Task Force recommendations were used by the Treasury to construct the repeal of the statutory OFR as a ‘symbolic’ deregulatory opportunity in order to gain political support. Overt (1-D) or covert (2-D) demonstrations of power by ‘big business’ were not evidenced in formulating the OFR repeal policy – it was instigated by Treasury officials based upon their expectations of what ‘big business’ wanted. But who did the Treasury believe were the specific beneficiaries of an OFR repeal? To whom was it ‘presentationally attractive’?

In considering the timing and handling of the OFR repeal, the internal ‘note to Chancellor’ dated 11 October 2005 recommends that,

we would need to persuade both DTI ministers and No. 10.<sup>11</sup> Our view is that this would play much better as part of any broader deregulatory package (potentially in the PBR<sup>12</sup> or CBI/IOD<sup>13</sup> speeches). Rolling back the OFR will not be universally welcomed. Environmental groups – and perhaps trade unions – will oppose this. In addition, it is important to prepare business, especially the CBI (there is a risk of criticism that we have made them spend significant amounts preparing for the OFR). (HM Treasury, 2005c: 1 emphasis in original).

The Treasury proceeded in its attempts to ‘prepare business’ during a meeting with an ‘informal advisory group’ representing a narrow range of business interests on 8 November 2005 which presented the repeal of the statutory OFR as a ‘deregulatory suggestion’ (HM Treasury, 2005a:1).<sup>14</sup>

By 11 November, a further note prompts the Chancellor to “secure the agreement” of key ministerial colleagues: Alan Johnson (DTI), Margaret Beckett (Department for Environment,

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<sup>11</sup> The office of the Prime Minister, Tony Blair.

<sup>12</sup> Pre-Budget Report.

<sup>13</sup> Institute of Directors.

<sup>14</sup> The group consisted of the Association of Private Client Brokers, the British Banking Association, the Investment Management Association, the London Investment Banking Association and the London Stock Exchange.

Food and Rural Affairs) and Patricia Hewitt (former DTI) (HM Treasury, 2005d). Alan Johnson and Margaret Beckett,

can be expected to have significant reservations about deregulating the OFR reporting requirements, given long-held positions on the importance of the additional reporting requirements for quoted companies (HM Treasury, 2005d: 4).

The DTI had long supported the statutory OFR as a complement to the proposed extension of directors' duties (Collinson et al., 2011). However, the notes highlight the relative power relations between Government departments at that time. Headed by the Prime Minister-in-waiting, Gordon Brown, the Treasury was able to select the OFR as a deregulatory option even though the DTI was notionally in charge of corporate reporting policy and despite the fact that they suspected the decision would be opposed by other Government departments.

The note also demonstrates the Treasury's concern for securing the support of the CBI. Despite noting anticipated opposition from environmental, corporate social responsibility and trade union groups, the ASB and ministerial colleagues, and a mixed reception from investment institutions and auditors (it noted the audit profession may be concerned over a "loss of an anticipated workflow") the Treasury nevertheless indicated that, "it is important that there is good support from business and investors", and noted that "informal soundings with the CBI suggest they would strongly support such a move" (HM Treasury, 2005d: 3-4).

Finally, a note dated 23 November specifically recommends that the Chancellor urgently discuss the repeal decision with ministerial colleagues (Johnson, Beckett, Hewitt and Hutton) (HM Treasury, 2005e). The urgency was presumably generated by the fact that the decision was going to be publicly announced on 28 November 2005. The CBI had already been consulted before key ministerial colleagues "at the end of October/start of November" (HM Treasury Solicitors, 2005: 8). According to Treasury solicitors,

the CBI official was asked, hypothetically, how he thought the CBI might react to this. He indicated that the CBI would be strongly supportive (HM Treasury Solicitors, 2005: 9).

The CBI had also been told of the Chancellor's intention to announce the decision at the CBI annual conference over the weekend of November 26/27 2005 (Treasury solicitors, 2005: 9). Unsurprisingly, after the withdrawal of the statutory OFR was announced, the CBI was one of the few groups publicly to support the move.

The note also suggests the Treasury was aware of the impact of the repeal on the ASB.

We would also expect the Accounting Standards Board to raise concerns about the policy reversal, as they have invested significant time and effort in developing the OFR

standard. The proposal in no way denigrates the good work of the Accounting Standards Board (HM Treasury, 2005d: 4).

However, unlike the CBI, the ASB (and its parent, the FRC) apparently received no forewarning of Treasury plans to repeal the statutory OFR despite both the FRC and the ASB containing board members representing the Government (although this was the DTI rather than the Treasury) and the FRC being headed by a former president of the CBI. The privileged position afforded by the Treasury to the CBI contrasts starkly with the position of the accounting standard setter. Similar to ministerial colleagues, the ASB was not forewarned despite the obvious relevance of the Treasury's deregulatory repeal policy on the status of the ASB's reporting standard (RS1) (Williams & Conley, 2007).

Although many representative interest groups are specifically named in the internal Government papers that discuss the decision to repeal the statutory OFR,<sup>15</sup> deference appears to be reserved for the CBI, in consulting upon the repeal proposals, seeking reaction on the repeal decision prior to discussion with other ministers and announcing the repeal at the CBI conference.

By outlining the UK political context at the time, the analysis shows how the Labour Government, in the run-up to the May 2005 election, sought to re-emphasise its support for business-friendly deregulation consistent with a neo-liberal economic ideology. The privileged position of the business sector derived from the Government's need to provide conditions favourable for business to thrive and provide employment for the electorate and the taxes necessary to sustain public services. By March 2005 deregulatory initiatives such as the Better Regulation Task Force specifically advised Government officials to proactively identify targets for deregulation. The deregulatory ideology enabled the Treasury to rationalise the repeal of the OFR as a policy choice in the absence of any concerted lobbying. Rather than reacting to overt (1-D) or covert (2-D) pressure from 'big business', Treasury officials instigated the deregulation of the OFR and then sought bodies such as the CBI to support it. Upon inquiring whether corporate lobbying played a significant role in the Treasury move to support current cost accounting in the UK during the development of inflation accounting in 1973, Robson (1994: 68) quotes a Treasury civil servant: "it was much more us thinking we know what industry want". In

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<sup>15</sup> Amnesty, ABI, ACCA, Association of Private Client Brokers, British Banking Association, Corporate Responsibility Coalition (CORE), Deloitte & Touche, ICAEW, the Institute of Directors, Institutional Investors Group on Climate Change, Investment Management Association, Justassurance, KPMG, London Investment Banking Association, London Stock Exchange, Morley, National Association of Pension Funds, National Consumer Council, Trade Union Congress, and the UK Social Investment Forum.

anticipating and predicting the needs of business, perhaps the Treasury was taking a very similar line with respect to the OFR? The regulatory preferences of Treasury officials were influenced by 3-D power relations in their desire to meet deregulatory targets in line with their political commitment to economic neo-liberalism. Headed by the ‘business friendly’ Chancellor and PM-in-waiting, Gordon Brown, the powerful Treasury operationalised the repeal of the OFR in anticipation of business support despite the opposition of other government departments.

The analysis continues by examining the reaction to the repeal announcement and considers why the Government did not gain the anticipated support.

## *5.2 The repeal reaction*

In general, both the repeal of the statutory OFR itself and the timing of the decision attracted widespread condemnation (for example, see Burgess & Eaglesham, 2005; Collinson et al., 2011). Criticism was voiced by interest groups representing institutional shareholders (see Williams & Conley, 2007), including those who the Treasury had consulted when formulating the repeal policy. For example, the Association of British Insurers (ABI) (2005) voiced its ‘considerable regret’ and several major asset management groups wrote to the DTI claiming corporate reporting could be destabilised by a lack of guidance on management commentary (Hanney, 2006; Lake, 2006).<sup>16</sup>

The decision met with strong criticism from the main professional accounting bodies who were presumably concerned over the attack on the independence of standard setting. For example, the chief executive of the Institute of Chartered Accountants in England & Wales (ICAEW) commented that they were,

concerned at the sudden nature of the Chancellor’s decision, given the time, effort and investment that has been put into the development and introduction of the Statutory OFR (accountingeducation.com, 2005).

The Chartered Institute of Management Accountants (CIMA) (2005b) stated that, we believe wholeheartedly in the value of the OFR. Confusing the OFR with a reduction in bureaucracy risks losing the benefits it will deliver to all stakeholders, particularly shareholders. That would be the wrong step and a fundamentally bad one,

- whilst the Association of Certified Chartered Accountants (ACCA) responded that, the new model has attracted broad support from the business community as a vehicle for a more broadly-based reporting function. From our contacts with companies and

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<sup>16</sup> Rutherford (2006) comments that the reaction of institutional investor groups demonstrated that there was a genuine demand from sophisticated investors for OFR-type disclosures.

investors, our understanding is that both groups have reacted positively to the introduction of the OFR. To abandon it at such a late stage, and before it even had the opportunity to prove its worth, calls for a full explanation from the government (Rayner, 2005).

Environmental groups were highly critical motivating Friends of the Earth to seek a judicial review of the decision. Concern was also voiced in the British Parliament. For example, John McFall, chairman of the Treasury Select Committee (and a Labour Member of Parliament), questioned whether the move would reduce bureaucracy given that the majority of the OFR requirements arose from the AMD and would therefore still require adherence in an ‘enhanced’ Business Review in the Directors’ Report (Jopson, 2006).

The response from the ASB was comparatively muted - the Financial Reporting Council (FRC), on behalf of the ASB, ‘noted’ the Chancellor’s comments (FRC, 2005) and declared that, “we are not in a position to demand OFRs but would encourage companies to publish them” (Buck & Burgess, 2005: 2). However, they did express their belief that the guidance provided by RS 1, now demoted to a ‘reporting statement’, remained best practice for management commentary (FRC, 2005).<sup>17</sup>

Accounting firms, commonly found to advocate the views of their ‘big business’ clients in lobbying on reporting standards, expressed divergent views. Ernst & Young and PwC fully supported the statutory OFR for listed companies (Phillips & Wyman, 2005) after the audit requirements and associated liability risk had been downgraded (see section 4). On the other hand Deloitte, “agreed with the CBI that the OFR as originally planned would be a significant burden” (Reynolds, 2006: 6). Deloitte’s close alignment with the CBI was further highlighted in the wording of a letter by its head of audit to Alun Michael, Minister of State for Industry and Regions, which claimed the burden on British business,

would have come from the need to meet detailed rules, to obtain legal advice particularly regarding forward looking information and to extend the work of auditors (Reynolds, 2006: 6).

This seemingly altruistic position can be contrasted with that taken by shareholder representatives such as the ABI who supported the statutory OFR even though their constituents would actually bear the additional auditing costs.

Overall, the repeal announcement was received negatively by the vast majority of interested parties including those who had not fully supported the statutory OFR but who were

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<sup>17</sup> Later, in their response to the IASB discussion paper on Management Commentary, the ASB also expressed a preference for mandatory guidance (ASB, 2006).



disappointed with the timing of its repeal. The only groups publicly supportive of the OFR repeal were the CBI, the British Chambers of Commerce, Deloitte and the London Stock Exchange. Although all four groups are arguably powerful institutions likely to represent the holders of capital, the repeal of the OFR did not appear to win the Government much political support, from elsewhere in the business sector.

In December 2005 shortly after the repeal announcement, the Treasury appeared to recognise their miscalculations within the 2005 Pre-Budget Report by stating that the “central requirements of the Business Review are largely identical to those of the statutory OFR” (HM Treasury, 2005f). The DTI’s original motivation for the statutory OFR was to provide a means for companies to report on a broader range of director duties (Collinson et al., 2011). During 2006, the extension of director duties led to the reinsertion of disclosures into the ‘enhanced Business Review’ for listed companies which were not specified in the AMD but had been required in the statutory OFR thereby contradicting the ‘gold-plating’ rationale. As noted by Collinson et al. (2011: 28), a 2010 post-implementation evaluation of the Companies Act 2006 undertaken by the UK Government reported that the Business Review was ‘seen as one of the least helpful areas of the Act’. Consequently in 2010, a newly elected Conservative-Liberal Party coalition government proposed that they would “reinstate an OFR to ensure that directors’ social and environmental duties have to be covered in company reporting” (HM Government, 2010: 10).<sup>18</sup>

The reaction to the repeal announcement and subsequent regulatory U-turns indicate that the repeal of the OFR did not generate the anticipated political capital. How did the Treasury misjudge that repealing the statutory OFR could be used as a business friendly deregulatory policy? The Treasury were not in charge of accounting matters, and the statutory OFR had been developed over several years. After widespread consultation conducted by the DTI, it had seemingly been accepted by most stakeholders and was ready for implementation (for example, see Tucker 2004). The internal briefing notes give some insight into how the Treasury formed those regulatory (mis)perceptions. The first reference to the OFR is made in a meeting with an individual from Hermes pension fund on 8 June 2005. The note opines that,

He thinks the OFR is colossally over-engineered and says this is also what the accountants are saying. If we wanted [a] deregulatory win with appeal for big business, a

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<sup>18</sup> Confusingly, they also state shortly afterwards that they will “end the so-called ‘gold-plating’ of EU rules” (HM Government, 2010: 10). At the time of writing, the UK coalition Government was still conducting a ‘narrative reporting’ consultation.

radical symbolic stripping-down of the OFR would go down incredibly well. (HM Treasury, 2005a:1).

As Williams & Conley (2007) point out, the viewpoint can be contrasted with Hermes' reputation for campaigning on corporate governance, environmentally and socially responsible corporate behaviour, improved ethical standards and its own commitment to long term investment relationships. The tone of the document appears to emphasise the individualistic nature of the views expressed rather than the institutional lobbying position of the Hermes pension fund. However, despite its individualistic tone, the note attempts to represent authoritatively the collective views of accountants and perhaps institutional investors. From this individual opinion, Treasury officials draw a general conclusion.

I see his point. Is it feasible? (HM Treasury, 2005a:1).

Notes from three further meetings suggest that the Treasury appears to seek support for a position that it has already taken after generalising from an individual opinion expressed in the meeting with Hermes. For example, in an internal 'filenote' made after meeting the ABI on 12 August 2005, Treasury officials state that the ABI,

dislike all the compromises made to the environmental and CSR lobby but think ASB has done a very good job of not making these more onerous with additional prescriptive requirements in the draft standard (HM Treasury, 2005a:1).

However, the note concludes that the meeting was "promising", suggesting that although the ABI liked the OFR "in principle", they might be amenable to supporting its repeal (HM Treasury, 2005a: 1).

In a meeting on 19 August 2005, the London Stock Exchange implied their support for the repeal of the OFR by suggesting that "the main focus of [the] OFR is to protect retail investors" and that it would not be used by professional investors. However, an alternative rationale for their support of the OFR's repeal is provided later in the 'filenote'. Both the 'enhanced' Business Review in the AMD and the statutory OFR only applied to 'listed' or 'quoted' companies (that is, those on the main list of the London Stock Exchange but not those companies on the Alternative Investment Market (AIM)). The London Stock Exchange advised that,

this has had a material impact on some companies' decisions about which market they trade on, with some choosing to remain on AIM if only to give them a couple of years to operate with lower levels of transparency so they can better establish their business (HM Treasury, 2005a:1).

The London Stock Exchange believed that the “increased transparency requirements” (HM Treasury, 2005a:1) of the OFR could push companies to choose to list on the AIM, thereby paying lower admission and annual fees to the Stock Exchange than those companies quoted on its main market. Although the London Stock Exchange recognised that the OFR would increase corporate transparency, their support for the OFR’s repeal and the alignment of their interests with those of the Treasury appear to be derived from financial self-interest.

Although the Treasury had identified the statutory OFR as a deregulatory opportunity, privately they opined that it,

represented a compromise between activists’ wants (who sought further mandatory reporting of non-financial information by more companies) and the wants of business and investors (who supported some additional disclosures but were concerned by the costs of additional regulation) (HM Treasury, 2005c:3).<sup>19</sup>

Although institutions identified in the internal documents are discussed in terms of whether they would support or oppose the repeal of the statutory OFR, the notes often focus on how to ‘prepare’ supporters and ‘handle’ opposition. They imply that a deregulatory, ‘gold-plating’ agenda, consistent with a neo-liberal ideology and designed to maintain political support, had been agreed and the selection of the OFR repeal was a largely arbitrary choice in the search for deregulatory opportunities. In the briefing notes, there is no consideration of other strategies that could decrease the disclosure requirements of the OFR by, for example, influencing the content of the accounting standard RS1.

In general, the repeal of the statutory OFR attracted widespread condemnation which, alongside the legal challenge, led to the Government to reconsider its approach. The next section links the case back to its theoretical foundation in considering why the ideological deregulatory initiative led to an unpredictable regulatory outcome.

## **6. Discussion**

Without lobbying or observable conflict, the repeal of the OFR was constructed as a vehicle through which Gordon Brown’s Treasury could demonstrate its deregulatory neo-liberal credentials to the business sector. From the early stages, the policy was designed to be part of a broader deregulatory package aimed at business and delivered via employer interest groups such

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<sup>19</sup> The 2004-05 report of the Treasury’s Financial Reporting Advisory Board presented to the House of Commons and regional parliaments suggests that the Treasury believed the statutory OFR and RS1 to be the most appropriate management commentary guidelines that should be followed by Government agencies (Financial Reporting Advisory Board, 2005: 34).

as the CBI or the Institute of Directors. The Treasury aligned its interests with the CBI under the presumption it would gain political support from the business sector. The language used by the Treasury in its internal briefing notes (for example, “prepare business, especially the CBI” and “we have made *them* spend significant amounts preparing for the OFR” (HM Treasury, 2005c:1 emphasis added)) suggests that they perceive the CBI as the key representative of business whose needs must be met. The CBI was prioritised by Treasury officials over other ministers and interest groups, and their support was used in the implementation and communication of the policy. This selective ‘consultation’ for which Friends of the Earth successfully challenged the British government excluded certain groups from representation or access to regulators.

However, the Treasury only approached the CBI after it identified the OFR as a deregulatory opportunity. The CBI were used to support, but not formulate, the policy and were used as a vehicle to communicate the policy. Other than the CBI, interest groups such as the ABI do not provide emphatic support for OFR repeal, and the support of the London Stock Exchange appears to be shaped by narrower financial considerations. No apparent attempt had been made by Treasury officials to gauge the views of ‘preparer’ companies. Rather than responding to concerted lobbying from particular interest groups, the internal briefing papers suggest that the repeal decision was instigated by the Treasury in seeking to operationalise a deregulatory initiative consistent with their political commitment to neo-liberalism. Within the political economy, this is perhaps unsurprising: the State defends the interests of the capitalist class as a whole and needs democratic legitimisation to validate fiscal regimes upon which it is dependent to deliver essential services (see Hacker & Pierson, 2002; Sikka, 2001). In the UK, the ‘City’ was a main driver of growth and tax revenues (Broadbent & Laughlin, 2002) and it can be argued that the New Labour party’s political success relied upon business sector support: presumably the Treasury were more sensitive to this dependency than other Government departments. The briefing notes suggest that the Treasury assumed that a programme of corporate deregulation would gain political support and credibility from business. In the prevailing social and political context, corporate deregulation was assumed to be efficient, rational and anti-bureaucratic consistent with a ‘light touch’ regulatory system supportive of a neo-liberal economic ideology – arguably, a pervasive belief system in period directly preceding the 2008 financial crisis. This ideology was expressed through deregulation and translated within the rhetoric of ‘gold-plating’ which, in 2005, characterised regulation beyond that required by the EU as inefficient and wasteful. Deregulation acted as a rationale that could justify the

selection of the OFR even though it was broadly supported by the majority of stakeholders. The internal papers reveal the influence at the time of governmental initiatives such as the Better Regulation Task Force and the Hampton Report, and officials sought opinions on what policy measures might fit with the deregulatory ideology. Local decision makers within the Treasury drew on the deregulatory rationale in justifying their political strategy.

The arrangement of power relations in the UK, the dependence of the State on ‘big business’ and the pursuit of a neo-liberal economic agenda, can be argued to have sustained what Haugaard (2009) describes as practical consciousness or *habitus*: a disposition that any ‘deregulatory’ measure would garner business support. Actors can be disposed to reinforcing relations of domination that fit with their knowledge of themselves as social agents (Clegg et al., 2006). The Treasury were not subject to overt (1-D power) or covert (2-D power) lobbying in choosing to repeal the OFR legislation – the OFR was selected for repeal by the Treasury because corporate deregulation was consistent with its political ideology and it was assumed this policy would be greeted favourably by ‘big business’ (3-D power). In the absence of any concerted lobbying, it can be argued that corporate deregulation was internalised by the Treasury as a ‘normal’, ‘rational’ policy. The normality of deregulation meant that it could be a natural disposition to sacrifice accounting regulation in order to gain political support from business.

Although the deregulatory agenda may have generated political support in other regulatory spaces, it can be argued to have largely ‘failed’ in this case. The Treasury had seemingly not recognised the compromises and bargains that had been reached between companies, regulators and other stakeholders in the formal lobbying processes. During the drafting of legislation, groups representing business had overtly lobbied, somewhat successfully, to ensure that the OFR maintained a shareholder-centric focus, did not significantly extend corporate accountability nor widen director liability. Furthermore, and perhaps more importantly, the surprise announcement by the Treasury destabilised the corporate reporting regulatory environment. The reaction to the repeal announcement indicates that firms and other stakeholders had accepted the statutory OFR and were prepared for its implementation. The stability of the regulatory environment appeared to have trumped regulatory change even where corporate deregulation was perceived by the Treasury to be advantageous to business.

The case, therefore, demonstrates the effect of political ideological power on regulatory decision making but, in doing so, highlights the unpredictable nature of its consequences. As those consequences depend upon the perceptions of regulatory decision makers and the local

context in which they operate, the regulatory outcomes may be unanticipated. The influence of power in accounting regulation can be recognised as being beyond simplistic causal and deterministic explanations and susceptible to unintended consequences. A key issue identified in this case was the value to stakeholders of regulatory stability – the unexpected and destabilising nature of the government intervention led to a state of regulatory uncertainty.

In contrast to analyses that characterise the influence of political ideology on accounting regulation as predictable, this case indicates how ideological hegemony can produce more ‘accidental or unintended outcomes’ (Robson, 1993:21). Although societal structures can shape and influence social choices, they cannot necessarily determine the outcomes arising from the complex interplay between actors (for example, see Broadbent & Laughlin, 2002). There is no simple causal chain (see Young, 1994) between tax revenues, public services, big business, political support and regulatory outcomes. As Lukes (2005) notes, power may have unpredictable effects where actors misinterpret the sources of power. The relationship between political ideology and the regulatory outcomes can, in this case, be characterised as more chaotic and unpredictable. The unintended consequences arising from the influence of political ideology rejects the determinism implied in studies that assume regulatory decisions are rational and based on complete information (see Robson, 1994). Due to the complexity inherent in accounting regulation, the case suggests that it may be difficult to impute causality from observed ex post associations between actor preferences and policy outcomes (Hacker & Pierson, 2002; Dur & De Bievre, 2007). As revealed by the private Treasury briefing notes, policy preferences will be formed after making calculations of the expected reactions of interested parties that can be susceptible to misperception, misunderstanding and human error (Hacker & Pierson, 2002). The repeal of the OFR was driven by the incoming leadership of a centre-left political party in an attempt to gain political support from business. However, the unexpected reaction of business and other stakeholders meant that the legacy of the OFR, and the disclosures it mandated, remained largely in force.

Prior research detailing Government intervention into accounting regulation has generally highlighted cases where strong economic imperatives and/or concerted lobbying have explicitly prompted Government action (see for example, Zeff, 2005; Ramanna, 2008; Cortese, 2011; Broadbent & Laughlin 2002; 2005; Toms et al., 2011). In contrast, the briefing papers reveal that the UK government was under no significant pressure from interest groups, and intervention was driven by (misplaced) political opportunism. The position of management

commentary in regulatory space allowed it to be used as a pawn to gain political support for Gordon Brown's Treasury. Unlike a financial reporting standard, the Government had direct control over the format and content of management commentary, and the role and scope of the private standard setter (the ASB) was contingent on a specific Statutory Instrument. In other settings, management commentary is not generally subject to the same private sector standard setting infrastructure (conceptual frameworks, governance arrangements, due processes) as disclosures within the financial statements and notes. Narrative reporting disclosures outside the financial statements and notes arguably remain a grey area in accounting regulation subject to a combination of company law (and therefore explicit governmental control) and best practice recommendations from private standard setters. For example, in the UK, the ASB did not regulate corporate reporting disclosures relating to, for example, corporate governance and executive remuneration.<sup>20</sup>

The heterogeneous nature of regulatory arrangements for narrative reporting disclosures including management commentary, corporate governance, remuneration disclosures and 'sustainability' reporting may enable standards to be subject to different and perhaps more direct forms of sectional interactions than those encountered in the formal, stable private sector standard setting arrangements that commonly exist at national and international levels. Companies reporting from different domains under IFRS GAAP will be subject to different management commentary regulations that reflect the different institutional settings. National regulatory arrangements, subject to national sectional interactions and power relations, remain the dominant force at the international level. This partially explains the anomalous position of why IFRS GAAP incorporates, for example, segmental reporting whilst management commentary currently remains outside explicit IFRS jurisdiction. Despite the differential national sources of influence in each regulatory setting, domestic institutional arrangements concerning management commentary act as the prominent force in how international regulators perceive and arrange international practices.

## **7. Summary**

The paper examined why the statutory OFR legislation was unexpectedly and controversially withdrawn shortly before its planned implementation, and sought to enrich our

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<sup>20</sup> Robson (1993) also notes how the chair of the predecessor to the ASB, the Accounting Standards Committee, believed that disclosure outside of the financial statements to be a matter for company legislation rather than private accounting standard setters.

understanding of this episode of governmental intervention into accounting regulation. It draws on internal Government briefing papers to present a detailed account of the process by which accounting legislation and standards for management commentary in the UK became subject to political opportunism on the part of the UK government.

The Government rationale for repeal of a statutory OFR was ostensibly driven by its negative view of the provision of additional disclosures in a statutory OFR above those dictated by the EU AMD. In justifying its move, the Treasury stated that,

this decision was made in the light of the Government's strong commitment to sustainable development, strategic forward looking narrative reporting and its policy of not imposing unnecessary burdens on UK companies, and taking into account the large body of evidence from previous consultations on narrative reporting (HM Treasury, 2006: 1).

However, internal Treasury papers, made publicly available as a result of a legal challenge against the Government decision, do not fully support any of these stated rationales. Therefore, the paper presents an alternative contextual study of the repeal of the statutory OFR.

It describes how the pursuit of a deregulatory agenda became politically expedient in 2005 and illustrates the role of the Better Regulation Task Force and Hampton Report in prompting Government officials to proactively identify deregulatory opportunities. Treasury officials perceived that corporate deregulation consistent with neo-liberal economic ideology would bolster political support from business for the head of the Treasury, Chancellor Gordon Brown, who was shortly to take over as Prime Minister with a vastly reduced parliamentary majority. The analysis details the process by which Treasury officials, outside their remit, identified the statutory OFR as a deregulatory opportunity even though it had been generally accepted by most stakeholders. The Treasury assumed that corporate deregulation would achieve political support from the business sector, regardless of the regulatory instrument and in the absence of any concerted lobbying campaign. The main body representing business in the UK, the CBI, were specifically targeted in the making, timing and announcement of the decision to repeal the statutory OFR.

However, by repealing the OFR as its chosen deregulatory policy, the Treasury can be argued to have misjudged the receptiveness of the business community to this instance of deregulation. The vast majority appeared to have accepted the OFR legislation after earlier lobbying successfully ensured it maintained a shareholder-centric focus, did not increase director liability and did not significantly extend corporate accountability. Large listed companies and the investment community were prepared for OFR implementation and the repeal announcement



destabilised the corporate reporting regulatory landscape. The repeal decision was not ‘pushed’ onto Government by concerted lobbying efforts. On the contrary, the Treasury proactively sought lobbyists who would support a ‘deregulatory opportunity’ consistent with the recommendations of the Better Regulation Task Force.

The paper seeks to contribute to the political economy of accounting regulation by using the internal government paper to understand the ‘black-boxed’ process by which regulation is influenced by political ideology. Lukes’ (2005) conception of 3-D power is used to understand the implicit influence of neo-liberal economic ideology within its wider social and political context. It draws on rare case evidence, seldom available in accounting regulatory research to demonstrate how a political ideology, embedded in a deregulatory discourse, came to influence management commentary accounting regulations with unintended consequences. The briefing papers suggest that regulatory preferences may be shaped by a hegemonic ideology, but regulatory outcomes are subject to the perceptions and actions of regulatory agents set within their local context. As the case demonstrates, these perceptions can be distorted, and regulatory outcomes can be a function of these misperceptions. The unintended consequences observed in this case provide a counterpoint to research assuming that the influence of political ideology on regulatory outcomes is predictable or deterministic.

These observations must however be considered in the light of the limitations of this interpretive paper which rest on the qualitative analysis of the case materials, particularly the briefing papers. The analysis relies on the interpretation of the case materials and the accuracy of the case materials in depicting the actions and events discussed in the paper.

In considering the development of management commentary more broadly, this case demonstrates the sensitivity to which extensions of the basic corporate reporting package are subject, and the tension between deregulatory ideology and the introduction of additional corporate reporting disclosures. Across the world, responsibility for management commentary generally occupies an uneasy position in regulatory space between mandatory legal requirements governed by politicians and voluntary best practice guidelines governed by quasi-independent standard setters. Despite being judged by the IASB to be within the remit of financial reporting, management commentary guidelines remain a voluntary ‘practice statement’, and not a mandatory international financial reporting standard (see IFRS, 2010). Companies complying with IFRS GAAP will be subject to different national management commentary regulations that are subject to national sectional interactions and power relations. Domestic institutional

arrangements remain as the influential force driving international management commentary practices. In common with other episodes of Government intervention into UK accounting regulation (for example, Broadbent & Laughlin, 2002; Robson, 1994), the case highlights the Treasury's dominance over corporate reporting standard setting and reveals how the Government department usually responsible for corporate reporting and accounting, the DTI, and the private sector standard setter, the ASB, were largely marginalised.

Given the potential of management commentary and other accepted narrative reporting frameworks to widen the scope of corporate accountability, director liability and audit liability, future studies could usefully consider the context, power relations and institutions shaping future developments at both national and international levels.

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